No. 16051

United States Court of Appeals

For the Ninth Circuit

American Properties, Inc., and the Estate of Stanley S. Sayres, Deceased, Harold L. Scott and A. R. Munger, Executors, and Madeleine A. Sayres,
Petitioners,

vs.

Commissioner of Internal Revenue, *Respondent.*

Petition for Review of Decision of the Tax Court of the United States
Honorable Craig S. Atkins, *Judge.*

REPLY BRIEF OF PETITIONERS

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PETITION FOR REVIEW OF DECISION OF THE TAX COURT OF THE UNITED STATES
HONORABLE CRAIG S. ATKINS, *Judge*

REPLY BRIEF OF PETITIONERS

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Page 17 of respondent's brief states that Mr. Sayres "was a prominent sportsman who gained national fame as an owner and driver of high speed power boats . . . ; in 1949 he attempted to shift the financial burden to one of his corporations . . . "

The fact is, and the record clearly shows, that Sayres had no fame in the racing world of any kind prior to June 26, 1950, when SLO-MO-SHUN IV broke the world's speed record. That boat was built *by the corporation* pursuant to the resolution of August 31, 1949, and was launched in October, 1949 (Tr. 31). The assertion that Sayres, as a prominent sportsman who gained national fame as an owner and driver of high speed power boats, shifted the financial burden thereof to his corporation is clearly untrue.

When the corporate resolution by which American Properties went into the boat venture was passed on August 31, 1949, Sayres was unknown in the racing world. It is easy logic to now look backward at the lack of profit in the venture and refer to the building of SLO-MO-SHUN IV by American Properties as "shifting Sayres' financial burden," if, indeed, he had any such financial burden in August, 1949. The substantial expense in issue in this case was incurred after August 31, 1949.

What was also "shifted" was the entire prospective profit potential of the venture when there was great enthusiasm for the success of the new boat being then built.

At the same page of his brief, respondent asserts that "numerous offers were received for the design and construction of the boats, but, all were turned down by taxpayer; . . . "

There is no reference to any portion of the record, nor can there be, to substantiate this assertion. The Tax Court found that one person made an offer to purchase in 1950 (Tr. 48). Sayres testified that Jones told him that Horace Dodge wanted to buy SLO-MO-SHUN IV, that he did not refuse to sell it, "but I wanted somebody to talk to me directly about it" (Tr. 141) and that if he had sold it in 1950, it would have ended any hopes of going on with the continuing development of the boat (Tr. 142, 145). Jones testified the Dodge offer was for two boats (Tr. 208). In any event there was only one offer, and that was communicated to Sayres indirectly through Jones. In fact, it is not entirely clear whether this proposal was made to Jones individually as a designer or

whether Dodge intended the offer to be to American Properties (Tr. 208).

It will be remembered that this isolated and only "offer" (if it was an offer, it was made in a most circuitous manner) occurred in June, 1950, when American Properties only had one boat of this design.

Whether this was an offer and whether it was refused is probably of negligible significance in the light of the circumstances under which the incident occurred. Respondent from this isolated occurrence, however, proceeds to the much repeated conclusion that the absence of profit motive "is revealed by his subsequent action in refusing to consider *any* offers for the designing or construction of the boats . . . " (Respondent's Brief, page 25—italics not supplied). Respondent seeks to justify the foregoing assertion by citing "R. 164-165, 168." A reference to those pages of the printed record will indicate that they do not relate to the subject matter of the respondent's assertion.

At page 20 of his brief, respondent asserts that petitioners do not contend, and cannot sustain a contention, that the individual taxpayers can deduct the expenses of the boat under Internal Revenue Code, Section 23 (A)(2). Respondent is quite correct that we did not so contend. However, respondent then proceeds as if we did so contend and, having set up the straw man, answers the "argument." We do not feel obliged to reply.

So that there is no misunderstanding about it, petitioners have consistently throughout this proceeding taken the position that either (1) American Properties can deduct the expense of the boat venture under Sec-

tion 23(a)(1)(A) as ordinary and necessary expense of that corporation's trade or business or, in the alternative, (2) that the expenses were nevertheless deductible by the individuals under Section 23(e) since incurred "in a trade or business" or in a "transaction entered into for profit, though not connected with the trade or business." This position of the petitioner is specifically asserted at petitioners' opening brief at pages 27, 36-37.[1]

At page 28-30 of the respondent's brief it is asserted that the "propitious" time for actively going into production and sale would have been in 1950 after winning the Gold Cup race and that the corporation did not construct an additional boat until February, 1951. It is true that SLO-MO-SHUN V was not launched until 1951, but the contract for its construction was signed by Jones and petitioner July 17, 1950 (Ex. 1), three weeks after SLO-MO-SHUN IV broke the world's record and one week *before* SLO-MO-SHUN IV won its first Gold Cup.

Respondent seems to be attempting to make some point (Respondent's Brief, page 30) of the fact that the corporation paid Jones $5,000 for designing SLO-MO-SHUN V although Jones' contract (Exhibit 1) was for $5,000 or ten per cent of the sales price, whichever was greater; that there was no sale and hence no intention of selling. This somewhat obscure point is made more confusing by the fact that the boat for which the $5,000

[1] The Tax Court in its opinion states (Tr. 53), "The petitioners contend, alternatively, that if the corporation was not engaged in the business then they were, and that the amounts, if taxable to them, would also be deductible by them."

was paid was built in 1951, after the tax years in question, and no evidence appears in the record as to whether that boat was, in fact, sold, although respondent infers that it was not.

Regarded in its true context, the contract with Jones is undoubtedly, together with the corporate resolution, the best documentary evidence of the profit purpose with which the boat venture was launched. This contract, undertaking as it does to pay Jones, in addition to time and materials, $5,000 or ten per cent of sales price, whichever is greater, on all boats sold would appear to be a most peculiar way to pursue an intent *not* to sell boats or designs and a more peculiar way to pursue a personal "hobby" of racing boats which are *not* for sale. There is no way to reconcile that agreement with respondent's hobby theory.

Sayres knew the boat was a smashing success when he signed the contract, Exhibit 1, promising on behalf of American Properties to pay Jones handsomely for boats that were sold. The unavoidable conclusion is that if Sayres had wanted to eschew profit as his purpose, abandon the idea of selling boats and designs and be the personal king of the racing world as his hobby, June 26, 1950, would seem to have been "the propitious time" to have done so.

On the contrary, seeing the boat had proved itself, he immediately and before it had even entered the Gold Cup race bound Jones to a contract geared to *sales* of boats and designs.

Jones, as respondent's witnesses, testified that the agreement was drawn in anticipation of the sale of boats

or designs and for profit (Tr. 209). It could have no other purpose.

Nor should one lose sight of the fact that it was in August, 1950, that American Properties borrowed some $26,000 from the Seattle-First National Bank to be used in connection with the boats (Tr. 34).[2] Chronologically then, this appears: On August 31, 1949, the corporate resolution was passed, the good faith of which is unchallenged, in which the corporation initiated the boat venture; the boat broke the world's record June 26, 1950; the contract with Jones anticipating sales of the boats was July 17, 1950; SLO-MO-SHUN IV won the Gold Cup July 22, 1950; and on August 7, 1950, the Seattle-First National Bank made a normal commercial loan to the corporation to be used by the corporation to finance its boat operations. This, together with the direct evidence from the participants clearly demonstrates that the profit motive was paramount throughout.

The respondent's case, in summary, is simply that the venture did not materialize in profit and *that* is the best evidence. We respectfully disagree. The findings of the Tax Court are clearly erroneous.

Respectfully submitted,

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[2] The Tax Court is somewhat confused about this date. The testimony is clear that it was 1950 (Tr. 172 to 175, Exhibit 6). Although the Tax Court finds as a fact (Tr. 34) that the loan was in August, 1950, in its opinion (Tr. 50) the Tax Court says: "In August, *1951*, the corporation borrowed $26,000 to be used in connection with the boats, but this was after his refusal of offers to buy boats and cannot be considered as indicating a profit motive."